



[4830-01-p]

DEPARTMENT OF THE TREASURY

Internal Revenue Service

26 CFR Part 1

[REG-136491-09]

RIN 1545-BI91

Utility Allowances Submetering

AGENCY: Internal Revenue Service (IRS), Treasury.

ACTION: Notice of proposed rulemaking and notice of public hearing.

SUMMARY: This document contains proposed regulations that amend the utility allowance regulations concerning the low-income housing tax credit. The proposed regulations update the utility allowance regulations to clarify that utility costs paid by a tenant based on actual consumption in a submetered rent-restricted unit are treated as paid by the tenant directly to the utility company. The proposed regulations affect owners of low-income housing projects that claim the credit, the tenants in those low-income housing projects, and the State and local housing credit agencies that administer the credit. This document also contains a notice of a public hearing on these proposed regulations.

DATES: Comments must be received by **[INSERT DATE 60 DAYS AFTER**

PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]. Outlines of topics to be discussed at the public hearing scheduled for Tuesday, November 27, 2012, must be received by **[INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**.

ADDRESSES: Send submissions to: CC:PA:LPD:PR (REG-136491-09), room 5205, Internal Revenue Service, PO Box 7604, Ben Franklin Station, Washington, DC 20044. Submissions may be hand-delivered Monday through Friday between the hours of 8 a.m. and 4 p.m. to CC:PA:LPD:PR (REG-136491-09), Courier's Desk, Internal Revenue Service, 1111 Constitution Avenue, NW., Washington, DC, or sent electronically, via the Federal eRulemaking Portal at www.regulations.gov (IRS REG-136491-09). The public hearing will be held in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW, Washington, DC.

FOR FURTHER INFORMATION CONTACT: Concerning the proposed regulations, David Selig, at (202) 622-3040; concerning submissions of comments, the hearing, or to be placed on the building access list to attend the hearing, Oluwafunmilayo Taylor, at (202) 622-7180 (not toll-free numbers).

SUPPLEMENTARY INFORMATION:

Background

This document contains proposed amendments to the Income Tax Regulations (26 CFR Part 1) relating to the low-income housing credit under section 42 of the Internal Revenue Code. Section 42(a) provides that, for purposes of section 38, the amount of the low-income housing credit determined under section 42 for any taxable year in the credit period is an amount equal to the applicable percentage of the qualified basis of each qualified low-income building. A qualified low-income building is defined in section 42(c)(2) as any building that is part of a qualified low-income housing project at all times during a statutorily prescribed period.

A qualified low-income housing project is defined in section 42(g)(1) as any project for residential rental housing if the project meets one of the following tests elected by the

taxpayer: (1) At least 20 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 50 percent or less of area median gross income; or (2) at least 40 percent of the residential units in the project are rent-restricted and occupied by individuals whose income is 60 percent or less of area median gross income. If a taxpayer does not meet the elected test, the project is not eligible for the section 42 credit.

To qualify as a rent-restricted unit within the meaning of section 42(g), the gross rent for the unit must not exceed 30 percent of the applicable income limitation. If any utilities are paid directly by the tenant, section 42(g)(2)(B)(ii) requires the inclusion in gross rent of a utility allowance determined by the Secretary, after taking into account the procedures under section 8 of the United States Housing Act of 1937.

On March 3, 1994, the Treasury Department and the IRS published in the **Federal Register** a Treasury Decision containing final regulations under section 42 (59 FR 10067). Among these regulations was §1.42-10, which provided guidance regarding the proper role of utility allowances in determining gross rent under section 42(g)(2)(B)(i) for rent-restricted units. On July 29, 2008, the Treasury Department and the IRS published in the **Federal Register** amendments to §1.42-10 (73 FR 43863).

If gross rent includes a utility allowance, §1.42-10(b), as amended, provides rules for determining the applicable utility allowance depending upon whether (1) the building receives rental assistance from the Rural Housing Service (RHS) (“RHS-assisted building”), (2) the building has any tenant that receives RHS rental assistance payments (“RHS tenant assistance”), (3) the rents and utility allowances of the building are reviewed by the Department of Housing and Urban Development (HUD) (“HUD-regulated building”), or (4) the building is not described in (1), (2), or (3) (“other building”). For an

RHS-assisted building and a building with RHS tenant assistance, §1.42-10(b)(1) and (b)(2) provides that the applicable utility allowance is the applicable RHS utility allowance.

For a HUD-regulated building, §1.42-10(b)(3) provides that the applicable utility allowance is the applicable HUD utility allowance. In other buildings, for all rent-restricted units occupied by tenants receiving HUD tenant assistance, §1.42-10(b)(4)(i) provides that the applicable utility allowance is the applicable Public Housing Authority (PHA) utility allowance established for the Section 8 Existing Housing Program. For all other tenants in rent-restricted units in other buildings, §1.42-10(b)(4)(ii) provides that the applicable utility allowance is the applicable PHA utility allowance under §1.42-10(b)(4)(ii)(A), a local utility company estimate under §1.42-10(b)(4)(ii)(B), an estimate from the State or local housing credit agency that has jurisdiction over the building under §1.42-10(b)(4)(ii)(C), the HUD Utility Schedule Model under §1.42-10(b)(4)(ii)(D), or an energy consumption model under §1.42-10(b)(4)(ii)(E).

After the 2008 amendment of the 1994 final regulations, commentators requested clarification about how the regulations apply to submetering arrangements. Some buildings in qualified low-income housing projects are submetered. Submetering measures tenants' actual utility consumption, and tenants pay for the utilities they use. A submetering system typically includes a master meter, which is owned or controlled by the utility company, with overall utility consumption billed to the building owner. In a submetered system, building owners (or their agents) use unit-based meters to measure utility consumption and prepare a bill for each residential unit based on actual consumption. The building owners (or their agents) retain records of utility consumption in each unit, and tenants receive documentation of utility costs as specified in the lease.

Notice 2009-44 (2009-21 IRB 1037) (see §601.601(d)(2)(ii)(b)) was issued to clarify that, for purposes of §1.42-10(a), utility costs paid by a tenant based on actual consumption in a submetered rent-restricted unit are treated as paid by the tenant directly to the utility company, and not by or through the owner of the building. Notice 2009-44 provides that, for RHS-assisted buildings under §1.42-10(b)(1), buildings with RHS tenant assistance under §1.42-10(b)(2), HUD-regulated buildings under §1.42-10(b)(3), and rent-restricted units in other buildings occupied by tenants receiving HUD rental assistance under §1.42-10(b)(4)(i), the applicable RHS or HUD rules apply.

For all other tenants in rent-restricted units in other buildings under §1.42-10(b)(4)(ii), Notice 2009-44 provides that the utility rates charged to tenants in each submetered rent-restricted unit must be limited to the utility company rates incurred by the building owners (or their agents). Notice 2009-44 also provides that, if building owners (or their agents) charge tenants a reasonable fee for the administrative costs of submetering, then the fee is not considered gross rent under section 42(g)(2). The fee must not exceed an aggregate amount per unit of 5 dollars per month unless State law provides otherwise. If the costs for sewerage are based on the tenants' actual water consumption determined with a submetering system and the sewerage costs are on a combined water and sewerage bill, then the tenants' sewerage costs are treated as paid directly by the tenants for purposes of the utility allowances regulations.

Even though Notice 2009-44 provides that the fee for the administrative costs of submetering is not considered gross rent under section 42(g)(2), the fee must be included in the gross income of the building owner under section 61.

Notice 2009-44 states that the utility allowance regulations would be amended to incorporate the guidance set forth in the notice and requested comments on the

provisions of the notice and issues resulting from the notice. Comments were received in response to Notice 2009-44, and the comments were taken into consideration in developing these proposed regulations. The proposed regulations generally incorporate the guidance in Notice 2009-44 with additional modifications as explained in more detail below. Additional comments are invited on the issues discussed in this preamble or on other issues related to utility submetering. See §601.601(d)(2)(ii)(b).

Summary of Comments on Notice 2009-44 and Explanation of Provisions

A commentator requested that ratio utility billing systems (commonly known as RUBS) be treated like submetering. Unlike submetering, RUBS use a formula that allocates a property's utility bill among its units based on the units' relative floor space, number of occupants, or some other quantitative measure, but not actual use by the unit. The IRS and the Treasury Department believe it is appropriate to treat a tenant's payment of a utility through a building owner (or its agent) as a direct payment to the utility only to the extent the tenant's utility cost is based on the unit's actual consumption. Therefore, the proposed regulations do not permit utility allowances for RUBS.

A commentator recommended that the regulations exclude or restrict "quasi-usage" allocation systems in buildings with a master chiller or boiler where the tenant's use of utilities is partly determined on an assumption not relating to actual use (such as the number of times a tenant turns on the system). Under Notice 2009-44 and these proposed regulations, if a submetering arrangement is not based on a unit's actual consumption of a utility, then the gross rent for that unit cannot include a utility allowance for that particular utility.

A commentator inquired as to the format and length of time records of resident utility consumption should be maintained. Existing rules address record retention.

Section 1.42-10(d) provides that the building owner must retain any utility consumption estimates and supporting data as part of the taxpayer's records for purposes of §1.6001-1(a).

A commentator suggested that the regulations should limit use of a PHA utility allowance for non-Section 8 units that are submetered. The commentator reasoned that the PHA utility allowance does not reflect actual utility consumption in the building, resulting in a low allowance in some cases. In the past, other commentators have stated that PHA utility allowances generally are too high because they are based on older buildings with higher utility costs compared to newly constructed or renovated low-income housing projects. The IRS and the Treasury Department have determined that, if building owners do not wish to expend resources to obtain utility allowances under one of the methods in §1.42-10(b)(4)(ii)(B), (b)(4)(ii)(C), (b)(4)(ii)(D), or (b)(4)(ii)(E), it is reasonable that they be permitted to use PHA utility allowances for units not subject to §1.42-10(b)(1), (b)(2), (b)(3), or (b)(4)(i).

Commentators also requested clarification on other rules contained in the §1.42-10 final regulations. A commentator asked whether State housing agencies are allowed to disapprove of certain methods for determining utility allowances listed in §1.42-10(b)(4)(ii). Existing rules address the role of State housing agencies in determining utility allowances. Thus, depending on the particular method under §1.42-10(b)(4)(ii), State housing agencies may require certain information before a method can be used, or they may disapprove use of a method. For example, §1.42-10(b)(4)(ii)(C) provides that a building owner may obtain a utility estimate for each unit in the building from the agency that has jurisdiction over the building "provided the Agency agrees to provide the estimate." That is, State housing agencies are not required to provide a utility estimate

under §1.42-10(b)(4)(ii)(C). Also, §1.42-10(b)(4)(ii)(E) provides that, under the energy consumption model, utility consumption estimates must be calculated by “either a properly licensed engineer or a qualified professional approved by the Agency that has jurisdiction over the building.” Thus, State housing agencies are not required to provide the approval described in §1.42-10(b)(4)(ii)(E). Comments are requested on whether approval by the agency with jurisdiction over the building should be necessary for both properly licensed engineers and qualified professionals or only for qualified professionals that are not properly licensed engineers.

A commentator asserted that there is confusion concerning mixed-financed properties, which may be subject to multiple Federal programs using different utility allowances. The commentator requested clarification on which methods may be used in buildings with multiple programs. If a building receives assistance from RHS or if any tenant in a building receives RHS rental assistance payments, then the applicable utility allowance for all rent-restricted units in the building is the utility allowance determined under the method prescribed by the RHS for the building (whether or not the building or its tenants receive other state or federal assistance). If neither a building nor any tenant in the building receives RHS housing assistance and the building is a HUD-regulated building, then the applicable utility allowance for all rent-restricted units in the building is the applicable HUD utility allowance. If a building is neither an RHS-assisted nor a HUD-regulated building, no tenant in the building receives RHS tenant assistance, and tenants in a rent-restricted unit in the building receive HUD rental assistance payments, then the applicable utility allowance for that unit is the applicable PHA utility allowance. For all other rent-restricted units not subject to any of the methods in §1.42-10(b)(1), (b)(2), (b)(3), or (b)(4)(i), the building owner may use the applicable PHA utility allowance or one

of the building methods in §1.42-10(b)(4)(ii)(B), (b)(4)(ii)(C), (b)(4)(ii)(D), or (b)(4)(ii)(E) for calculating utility allowances for all rent-restricted units in the building.

The proposed regulations modify the requirements in Notice 2009-44 in the following manner: First, if two or more utilities such as electricity and water are treated as submetered under the proposed regulations, then the building owner (or its agent or other party acting on behalf of the building owner) must separately state the amount billed to the tenants for each submetered utility.

Second, if a building owner imposes an administrative fee on a unit's tenants for the costs of administering a submetering arrangement, then the fee generally is not included in gross rent for purposes of section 42(g)(2). The exclusion from gross rent does not apply to any amount by which the aggregate monthly fee for all of a unit's utilities under one or more submetering arrangements exceeds the lesser of the following: (A) Five dollars per month or (B) The owner's actual monthly costs paid or incurred for administering the arrangement (whether internal costs or amounts paid to third parties).

For this purpose, the owner's actual costs include internal costs (such as amounts paid to employees) and external costs (such as amounts paid to third-party service providers) for administering the submetering arrangement, as well as that month's portion of costs that relate to the submetering equipment and that are not included in the building's eligible basis under section 42(d). The goal of these restrictions is to disallow any exclusion from gross rent beyond the extent to which a fee represents a reasonable reimbursement to the owner for the owner's otherwise unreimbursed actual costs for administering the submetering arrangement. The IRS and the Treasury Department request comments on whether or not rules are needed to address the building owner's

determination of actual costs when a utility company administers a submetering arrangement on behalf of the building owner and includes in the utility rate an amount for its services that is not separately stated.

Third, the proposed regulations remove the requirement in Notice 2009-44 that the administrative fee must not exceed an aggregate amount per unit of 5 dollars per month (unless State law provides otherwise). Instead of that prohibition, the proposed regulations merely require inclusion in gross rent for any amounts charged in excess of the lesser of five dollars or actual administrative costs.

The proposed regulations also amend §1.42-10(b)(4)(ii)(A). Section 1.42-10(b)(4)(i) provides rules for determining the utility allowance of rent-restricted units occupied by tenants receiving HUD rental assistance. Section 1.42-10(b)(4)(ii)(A) provides that, if none of the rules of §1.42-10(b)(1), (b)(2), (b)(3), and (b)(4)(i) apply to any rent-restricted units in a building, then the utility allowance for the units may be determined under §1.42-10(b)(4)(ii)(B), (b)(4)(ii)(C), (b)(4)(ii)(D), or (b)(4)(ii)(E). Some commentators have interpreted §1.42-10(b)(4)(ii)(A) to mean that, if a tenant receiving HUD rental assistance occupies a rent-restricted unit in a building, then the methods described in §1.42-10(b)(4)(ii)(B), (b)(4)(ii)(C), (b)(4)(ii)(D), and (b)(4)(ii)(E) are not available for determining utility allowances for any other rent-restricted units in the same building. This result was not intended. The proposed regulations amend §1.42-10(b)(4)(ii)(A) to clarify that for all rent-restricted units not subject to the rules of §1.42-10(b)(1), (b)(2), (b)(3), and (b)(4)(i) for determining the appropriate utility allowance for a rent-restricted unit, the owner may choose one of the options under §1.42-10(b)(4)(ii)(B), (b)(4)(ii)(C), (b)(4)(ii)(D), and (b)(4)(ii)(E) or the applicable PHA utility allowance for determining the utility allowance for those rent-restricted units.

Special Analyses

It has been determined that this notice of proposed rulemaking is not a significant regulatory action as defined in Executive Order 12866, as supplemented by Executive Order 13563. Therefore, a regulatory assessment is not required. It also has been determined that section 553(b) of the Administrative Procedure Act (5 U.S.C. chapter 5) does not apply to this regulation, and because the regulation does not impose a collection of information on small entities, the Regulatory Flexibility Act (5 U.S.C. chapter 6) does not apply. Pursuant to section 7805(f) of the Internal Revenue Code, this regulation has been submitted to the Chief Counsel for Advocacy of the Small Business Administration for comment on its impact on small business.

Comments and Public Hearing

Before these proposed regulations are adopted as final regulations, consideration will be given to any comments that are submitted timely to the IRS prescribed in this preamble under the “Addresses” heading. The IRS and the Treasury Department request comments on all aspects of the proposed rules. All comments will be available at www.regulations.gov or upon request.

A public hearing has been scheduled for Tuesday, November 27, 2012, at 10 a.m. in the Auditorium of the Internal Revenue Building, 1111 Constitution Avenue, NW., Washington, DC. Due to building security procedures, visitors must enter at the Constitution Avenue entrance. In addition, all visitors must present photo identification to enter the building. Because of access restrictions, visitors will not be admitted beyond the immediate entrance area more than 30 minutes before the hearing starts. For information about having your name placed on the building access list to attend the hearing, see the “FOR FURTHER INFORMATION CONTACT” section of this preamble.

The rules of 26 CFR 601.601(a)(3) apply to the hearing. Persons who wish to present oral comments at the hearing must submit electronic or written comments and an outline of the topics to be discussed and the time to be devoted to each topic (signed original and eight (8) copies) by **[INSERT DATE 60 DAYS AFTER PUBLICATION OF THIS DOCUMENT IN THE FEDERAL REGISTER]**. A period of 10 minutes will be allotted to each person for making comments. An agenda showing the scheduling of the speakers will be prepared after the deadline for receiving outlines has passed. Copies of the agenda will be available free of charge at the hearing.

Drafting Information

The principal author of these regulations is David Selig, Office of the Associate Chief Counsel (Passthroughs and Special Industries), IRS. However, other personnel from the IRS and the Treasury Department participated in their development.

List of Subjects in 26 CFR Part 1

Income taxes, Reporting and recordkeeping requirements.

Proposed Amendments to the Regulations

Accordingly, 26 CFR part 1 is proposed to be amended as follows:

PART 1--INCOME TAXES

Paragraph 1. The authority citation for part 1 continues to read in part as follows:

Authority: 26 U.S.C. 7805 * * *

Par. 2. Section 1.42-10 is amended by:

1. Adding a sentence after the first sentence of paragraph (a).
2. Revising the first sentence of paragraph (b)(4)(ii)(A).
3. Adding paragraph (e).

The additions and revision read as follows:

§1.42-10 Utility allowances.

(a) * * * For purposes of the preceding sentence, if the cost of a particular utility for a residential unit is paid pursuant to an actual-consumption submetering arrangement within the meaning of paragraph (e)(1) of this section, then that cost is treated as being paid directly by the tenant(s) and not by or through the owner of the building. * * *

* * * * *

(b) * * *

(4) * * *

(ii) * * *

(A) * * * If none of the rules of paragraphs (b)(1), (b)(2), (b)(3), and (b)(4)(i) of this section apply to determine the appropriate utility allowance for a rent-restricted unit, then the appropriate utility allowance for the unit is the applicable PHA utility allowance. * * *

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(e) Actual-consumption submetering arrangements--(1) Definition. For purposes of this section, an actual-consumption submetering arrangement for a utility in a residential unit possesses all of the following attributes:

(i) The building owner (or its agent or other party acting on behalf of the building owner) pays the utility provider for the particular utility consumed by the tenants in the unit;

(ii) The tenants in the unit are billed for, and pay the building owner (or its agent or other party acting on behalf of the building owner) for, the unit's consumption of the particular utility;

(iii) The billed amount reflects the unit's actual consumption of the particular utility. In the case of sewerage charges, however, if the unit's sewerage charges are combined

on the bill with water charges and the sewerage charges are determined based on the actual water consumption of the unit, then the bill is treated as reflecting the actual sewerage consumption of the unit; and

(iv) The utility rate charged to the tenants of the unit does not exceed the utility company rate incurred by the building owner for that particular utility.

(2) Special rules--(i) Fees. If the owner charges a unit's tenants an administrative fee for the owner's actual monthly costs of administering an actual-consumption submetering arrangement, then the fee is not considered gross rent for purposes of section 42(g)(2). The preceding sentence, however, does not apply unless the fee is computed in the same manner for every unit receiving the same submetered utility service, nor does it apply to any amount by which the aggregate monthly fee or fees for all of the unit's utilities under one or more actual-consumption submetering arrangements exceed the lesser of--

(A) Five dollars per month; or

(B) The owner's actual monthly costs paid or incurred for administering the arrangement.

(ii) Actual costs. For purposes of paragraph (e)(2)(i)(B) of this section, the owner's actual costs of administering an actual-consumption submetering arrangement include amounts paid to employees, independent contractors, and service providers for administering the submetering arrangement and allocable costs that relate to submetering equipment and that are not included in the building's eligible basis under section 42(d).

Par. 3. Section 1.42-12 is amended by adding paragraph (a)(5) to read as follows:

§1.42-12 Effective dates and transitional rules.

(a) * * *

(5) Submetered buildings. The second sentence in §1.42-10(a), the first sentence in §1.42-10(b)(4)(ii)(A), and §1.42-10(e) apply to utility allowances determined on or after the date the final regulations are published in the **Federal Register**. Until the date the final regulations are published in the **Federal Register**, taxpayers may rely on Notice 2009-44 (2009-21 IRB 1037; May 26, 2009) (see §601.601(d)(2)(ii)(b) of this chapter) for taxable years beginning on or after July 29, 2008.

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Steven T. Miller

Deputy Commissioner for Services and Enforcement.

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